

**EASTERN KENTUCKY UNIVERSITY
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As of June 30, 2003**

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Eastern Kentucky University
June 30, 2003

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Independent Accountants' Report

Board of Regents
Eastern Kentucky University
Richmond, Kentucky

We have audited the accompanying basic financial statements of Eastern Kentucky University (University), a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2003, and its changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12, in 2003, the University changed its method of accounting for Federal Perkins Loan Program capital contributions.

The accompanying management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Solutions
for
Success

BKD, LLP

December 19, 2003

Eastern Kentucky University

Management's Discussion and Analysis

June 30, 2003

Introduction

Eastern Kentucky University (University) is pleased to present its financial statements for fiscal year 2003. The Management Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial performance of the University for the year ended June 30, 2003. Management has prepared this discussion, along with the financial statements and related notes, to provide summary financial information. The MD&A should be read in conjunction with the accompanying financial statements and notes, which follow this section.

Financial Highlights

- The University's financial position remained strong as of June 30, 2003, with assets of \$229,000,000 and liabilities of \$84,000,000. Net assets, which represent the University's residual interest in assets after liabilities are deducted, were \$145,000,000 or 63% of total assets.
- Financial operations were in accordance with the budget plan approved by the board of regents. Operating revenues were \$112,000,000 and operating expenses were \$176,000,000, resulting in a loss from operations of \$64,000,000. Nonoperating revenues, including \$72,000,000 in state appropriations, net of nonoperating expenses, were \$66,000,000, which, when combined with the loss from operations, resulted in an overall increase in net assets of \$2,000,000 before other revenues, expenses, gains or losses. Depreciation of \$9,200,000, which reflects the decrease in carrying amounts resulting from the use of capital assets, is included in the net operating loss and is not intended to be covered by operating revenues but by funding provided by the state in the form of capital appropriations.

Using the Annual Report

This annual report consists of a series of financial statements that have been prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*.

Reporting Entity

The University is a component unit of the Commonwealth of Kentucky (Commonwealth).

Statement of Net Assets

The statement of net assets presents the assets, liabilities and net assets of the University as of the end of the fiscal year. The statement of net assets is a point in time financial statement. The purpose of the statement of net assets is to present to the readers of the financial statements a fiscal snapshot of the University. The statement of net assets presents end-of-year data concerning assets (current and noncurrent), liabilities (current and noncurrent) and net assets (assets minus liabilities). Net assets, the difference between total assets and total liabilities, is an important indicator of the current financial condition, while the change in net assets is an indicator of whether the overall financial position has improved or worsened during the year.

Eastern Kentucky University
Management's Discussion and Analysis
June 30, 2003

From the data presented, readers of the statement of net assets are able to determine the assets available to continue the operations of the institution. They are also able to determine how much the University owes vendors, investors and lending institutions. Finally, the statement of net assets provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the University.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the University's equity in capital assets owned by the University. The next category is restricted net assets, which are available for expenditure by the University but must be spent for purposes as determined by donors and/or external entities. The final category is unrestricted net assets. Unrestricted assets are available to the University for any lawful purpose of the University. However, the unrestricted net assets may be committed by the University for various projects and therefore, not available for other purposes.

Table 1: Condensed Statement of Net Assets

(amounts in thousands)

Assets

Current assets	\$ 58,923
Capital assets, net	161,982
Other noncurrent assets	<u>7,920</u>
Total assets	<u>\$ 228,825</u>

Liabilities

Current liabilities	\$ 24,226
Noncurrent liabilities	<u>60,085</u>
Total liabilities	<u>\$ 84,311</u>

Net Assets

Invested in capital assets, net of related debt	\$ 95,676
Restricted, expendable	37,862
Unrestricted	<u>10,976</u>
Total net assets	<u>\$ 144,514</u>

Eastern Kentucky University

Management's Discussion and Analysis

June 30, 2003

- Assets: As of June 30, 2003, the University's total assets amount to approximately \$228,800,000. Capital assets (land, building, equipment, etc.), net of accumulated depreciation, represented the University's largest asset, totaling \$162,000,000 or 71% of total assets. Current assets of \$59,000,000 was the next largest at 26%. Current assets consist principally of cash, current investments, current receivables and inventories. Other assets include the noncurrent portion of investments and loans receivable.
- Liabilities: As of June 30, 2003, the University's liabilities totaled approximately \$84,300,000. Bonds and lease payables for educational buildings and the housing system represented \$66,465,000 or 79% of total liabilities. Those due for repayment during the upcoming year amount to \$6,400,000, \$3,700,000 of which are funded by earmarked state appropriations and an additional \$1,000,000 by lease agreements with the state. The remainder is funded from housing revenues.
- Net Assets: Net assets at June 30, 2003, totaled approximately \$144,500,000 or 63% of total assets. Net assets invested in capital assets, net of related debt, totaled \$95,700,000 or 66% of total net assets. Restricted net assets totaled \$37,800,000 or 26% of total net assets. Restricted net assets are subject to externally imposed restriction governing their use. Unrestricted net assets accounted for \$11,000,000 or 8% of total net assets. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the unrestricted net assets have been designed for support of academic programs and initiatives, capital projects or working capital requirements. These current designations for these unrestricted assets are as follows:

Table 2: Designation of Unrestricted Net Assets

Inventories	\$ 346,747
Outstanding encumbrances	2,043,399
Incomplete University-funded capital projects	1,537,952
Indirect cost commitment	18,509
Health care self-insurance reserve	1,300,000
Departmental commitments	2,981,397
State trust funds	2,330,631
Auxiliary working capital	255,630
Unexpended plant funds	11,750
Uncommitted funds	<u>149,573</u>
Unrestricted net assets	<u>\$ 10,975,588</u>

Eastern Kentucky University
Management's Discussion and Analysis
June 30, 2003

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets are based on the activity presented in the statement of revenues, expenses and changes in net assets. The purpose of the statement is to present the revenues of the University, both operating and nonoperating, and the expenses of the University, both operating and nonoperating, and any other revenues, expenses, gains and losses of the University.

This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the goods or services, regardless of when cash is exchanged.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided. For example, state appropriations are considered under GASB Statement No. 35 to be nonoperating because they are considered to be provided by the legislature to the University without the legislature directly receiving commensurate goods and services for this revenue. Accordingly, the University reports an operating loss for the year prior to the addition of nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. Tuition must be reduced by institutional scholarships and governmental aid and is reported net of scholarship allowances in the financial statements.

Table 3: Condensed Statement of Revenues, Expenses and Changes in Net Assets
(amounts in thousands)

Operating revenues	\$ 111,556
Operating expenses	<u>175,880</u>
Operating loss	(64,324)
Nonoperating revenues	<u>66,107</u>
Loss before other revenues, expenses, gains or losses	1,783
Other revenues, expenses, gains or losses	<u>1,088</u>
Increase in net assets	2,871
Net Assets, Beginning of Year, as Adjusted	<u>141,643</u>
Net Assets , End of Year	<u>\$ 144,514</u>

Eastern Kentucky University
Management's Discussion and Analysis
June 30, 2003

The statement of revenues, expenses and changes in net assets reflects an increase in the net assets at the end of the year. Some highlights of the information presented on the statement are as follows:

- Gross tuition revenue (prior to netting of scholarship allowances of \$17,653,768) increased by \$4,000,000. The increase was principally the result of a 9.5% tuition increase and an enrollment increase of 2.5%.
- State appropriations were budgeted to decrease 1.9% for 2002-03 as a result of budget reductions occurring in 2001-02. During the year, state appropriations were decreased 1.5% or \$1,100,000. This reduction was offset by specified reductions in operating budgets and utilization of a portion of the contingency budget. An additional restricted state appropriation in the amount of \$900,000 was approved during the year to assist the University with emergency upgrading of the electrical distribution systems on campus.
- Personnel costs increased approximately 3.0% because of a 2.7% general salary increase and the increase in University-funded-health insurance costs.

Statement of Cash Flows

The final statement presented is the statement of cash flows. The statement of cash flows presents detailed information about the cash activity of the University during the year. The statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by the operating activities of the University. The second section reflects cash flows from noncapital financing activities. This section reflects the cash received and spent for nonoperating, noninvesting and noncapital financing purposes. The third section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital assets and related items. The fourth section reflects the cash flows from investing activities and shows the purchases, proceeds and interest received from investing activities. The fifth section reconciles the operating loss reflected on the statement of revenues, expenses and changes in net assets to the net cash used by operating activities.

Table 4: Condensed Statement of Cash Flows

(amounts in thousands)

Cash Provided by (Used in)	
Operating activities	\$ (56,317)
Noncapital financing activities	65,562
Capital and related financing activities	(25,430)
Investing activities	<u>14,055</u>
Net Change in Cash and Cash Equivalents	(2,130)
Cash and Cash Equivalents, Beginning of Year	<u>40,049</u>
Cash and Cash Equivalents, End of Year	<u>\$ 37,919</u>

Eastern Kentucky University

Management's Discussion and Analysis

June 30, 2003

Capital Asset and Debt Administration

The University completed the \$20,000,000 Student Services Building and the \$28,000,000 Law Enforcement Training Facility during the year being reported. Construction continues on the Business and Technology Building, Combs Residence Hall Renovation, Health Education Center Phase I, High Voltage Electrical Distribution System and the Southeast Regional Postsecondary Education Center at Corbin. There were no new bond issues during the year.

Economic Factors Impacting Future Periods

The following are known facts and circumstances that could affect future financial results:

- Tuition rates for fiscal year 2004 were increased approximately 9.38%. The net increase is expected to generate additional operating revenues of approximately \$6,800,000. However, the University's tuition rates continue to be approximately 10% lower than the average of the other comprehensive universities in the Commonwealth and may require further adjustments in the future.
- The Commonwealth continues to predict reduced revenues during the 2003-04 year. With the Commonwealth's current budget situation, it is not clear if a mid-year budget reduction will occur and if higher education will be included in that possible reduction.
- The current economic situation in the Commonwealth will require the University to identify and secure additional external funding sources and continue to contain costs. The University has invested additional resources in fundraising and is preparing to execute the first phase of a capital campaign.
- The University anticipates enrollment will continue to increase and intends to meet the Council on Postsecondary Education targets for growth, retention and graduation.
- The 2003-06 Eastern Kentucky University Strategic Plan (Plan), "Moving Forward Together" was approved by the board of regents in June 2003. The Plan has been developed to prepare the University to respond effectively and proactively in the rapidly changing higher education environment and is dedicated to managing external expectations and internal goals and aspirations within its resource base.

Eastern Kentucky University
Statement of Net Assets
June 30, 2003

Assets

Current Assets

Cash and cash equivalents	\$ 33,130,407
Restricted cash and cash equivalents	4,789,235
Investments	5,459,000
Restricted investments	6,000
Accrued interest receivable	449,518
Accounts receivable, net allowance of \$5,987,420	13,775,581
Loans to students, net allowance of \$52,043	817,152
Inventories	454,944
Prepaid expenses	<u>41,422</u>

Total current assets	<u>58,923,259</u>
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Noncurrent Assets

Investments	2,631,710
Loans to students, net allowance of \$311,376	5,288,027
Capital assets, net of accumulated depreciation of \$144,770,456	<u>161,982,348</u>

Total noncurrent assets	<u>169,902,085</u>
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Total assets	\$ <u>228,825,344</u>
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Eastern Kentucky University
Statement of Net Assets
June 30, 2003

Liabilities and Net Assets

Current Liabilities

Accounts payable	\$ 4,744,293
Other accrued liabilities	1,632,030
Accrued interest	691,100
Accrued salaries and benefits	2,225,657
Accrued compensated absences	2,572,516
Payroll withholding payable	758,702
Refundable deposits	498,270
Assets held for others	254,417
Deferred revenue	4,469,498
Bonds payable	5,430,000
Leases payable	<u>950,000</u>

Total current liabilities	<u>24,226,483</u>
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Noncurrent Liabilities

Bonds payable, noncurrent portion	36,055,000
Lease payable, noncurrent portion	<u>24,030,000</u>

Total noncurrent liabilities	<u>60,085,000</u>
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Total liabilities	<u>84,311,483</u>
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Net Assets

Invested in capital assets, net of related debt	95,675,768
Restricted	
Expendable for capital projects	23,874,938
Expendable for debt service	7,092,375
Expendable for loans to students	6,895,192
Unrestricted	<u>10,975,588</u>

Total net assets	<u>\$ 144,513,861</u>
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Eastern Kentucky University
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2003

Operating Revenues

Tuition and fees, net	\$ 29,808,342
Federal grants and contracts	42,421,896
State grants and contracts	19,805,040
Nongovernmental grants and contracts	2,955,610
Sales and services of educational activities	3,228,018
Auxiliary enterprises – housing	3,723,160
Auxiliary enterprises – other	365,695
Other operating revenues	<u>9,248,704</u>

Total operating revenues	<u>111,556,465</u>
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Operating Expenses

Education and general	
Instruction	62,122,219
Research	682,215
Public service	31,966,568
Libraries	2,072,847
Academic support	13,818,363
Student services	10,550,247
Institutional support	19,446,537
Operations and maintenance of plant	11,519,128
Depreciation	8,561,472
Student financial aid	9,027,844
Auxiliary enterprises	
Housing and other auxiliaries	5,361,301
Depreciation	641,287
Other expenses	<u>109,834</u>

Total operating expenses	<u>175,879,862</u>
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Operating Loss	<u>(64,323,397)</u>
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Nonoperating Revenues (Expenses)

State appropriations	71,668,300
Investment income	1,195,331
Interest expense	(3,137,424)
Other nonoperating expenses	<u>(3,619,110)</u>

Total nonoperating revenues	<u>66,107,097</u>
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Eastern Kentucky University
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2003

Income before Capital Appropriations and Federal Capital Support	\$ 1,783,700
Capital appropriations	900,000
Federal capital support	<u>187,810</u>
Increase in Net Assets	<u>2,871,510</u>
Net Assets, Beginning of Year, as Previously Reported	150,272,857
Adjustments applicable to prior year	(14,623,839)
Cumulative effect of change in accounting principle	<u>5,993,333</u>
Net Assets, Beginning of Year, as Restated	<u>141,642,351</u>
Net Assets, End of Year	<u>\$ 144,513,861</u>

Eastern Kentucky University

Statement of Cash Flows

Year Ended June 30, 2003

Operating Activities

Tuition and fees	\$ 28,946,861
Grants and contracts	62,557,691
Payments to suppliers	(25,927,515)
Payments for utilities	(5,091,628)
Payments to employees	(99,407,044)
Payments for benefits	(25,159,811)
Payments to students	(8,882,666)
Loans issued to students and employees	(1,763,848)
Collection of loans to students and employees	960,433
Federal reimbursement of canceled loans	191,970
Auxiliary enterprise charges	
Residence halls	4,134,937
Other	341,553
Sales and services of educational activities	3,228,018
Other receipts	<u>9,554,235</u>
Net cash used in operating activities	<u>(56,316,814)</u>

Noncapital Financing Activities

State appropriations	67,967,900
Other	<u>(2,406,054)</u>
Net cash provided by noncapital financing activities	<u>65,561,846</u>

Capital and Related Financing Activities

Capital appropriations	4,788,210
Purchase of capital assets	(20,253,937)
Principal paid on debt and capital leases	(6,835,000)
Interest paid on debt and capital leases	(3,201,655)
Recovery of bond issuance costs	<u>72,663</u>
Net cash used in capital and related financing activities	<u>(25,429,719)</u>

Investing Activities

Proceeds from sales and maturities of investments	26,590,896
Interest on investments	1,238,678
Purchase of investments	<u>(13,774,329)</u>
Net cash provided by investing activities	<u>14,055,245</u>

Eastern Kentucky University
Statement of Cash Flows
Year Ended June 30, 2003

Decrease in Cash and Cash Equivalents	\$ (2,129,442)
Cash and Cash Equivalents, Beginning of Year	<u>40,049,084</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 37,919,642</u></u>
Reconciliation of Operating Loss to Net Cash Used in Operating Activities	
Operating loss	\$ (64,323,397)
Depreciation expense	9,202,759
Loan cancellations	191,970
Changes in operating assets and liabilities	
Accounts receivable, net	265,867
Loans to students	(803,415)
Inventories	(13)
Prepaid expenses	(28,622)
Accounts payable	1,041,506
Accrued liabilities	1,086,472
Refundable deposits	(14,610)
Assets held for others	(16,444)
Deferred revenue	<u>(2,918,887)</u>
Net Cash Used in Operating Activities	<u><u>\$ (56,316,814)</u></u>

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Organization

Eastern Kentucky University (University) is a regional, coeducational, public institution of higher education offering general and liberal arts programs and pre-professional and professional training in education and various other fields at both the undergraduate and graduate levels. Located in Richmond, Kentucky, the University has a distinguished record of over nine decades of educational service to the Commonwealth of Kentucky (Commonwealth).

Reporting Entity

The University is a component unit of the Commonwealth and is included in the basic financial statements of the Commonwealth. These financial statements do not include the financial operations and financial position of the Eastern Kentucky University Foundation, Inc. (Foundation), which is a corporation formed for educational, charitable and public purposes in accordance with the provision of KRS 273.010. Specifically, it was founded to cooperate with the University and with the board of regents (Board) of the University in the promotion of the educational, civic and charitable purpose of the University and Board in any lawful manner deemed appropriate by the Board. This purpose includes the encouragement of scholarship and research and the promotion of the prestige, expansion and development of the University, including the development of its physical plant, its faculty and the assistance of its students and alumni. The Foundation is considered to be an affiliate of the University, as certain officers of the Foundation are also officers of the University.

These financial statements also do not include the financial operations and financial position of Arlington Association, Inc. (Arlington), a domestic nonstock, non-profit corporation, organized to promote closer relationships among the faculty, staff and alumni of the University through the operation of a club providing organized programs of social and recreational activities, and in furtherance of said purpose, to create a better understanding of the educational activities and opportunities at the University.

Basis of Accounting and Presentation

The financial statements of the University have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally federal and state grants and state appropriations) are recognized when all applicable eligibility requirements are met. Internal activity and balances are eliminated in preparation of the financial statements unless they relate to services provided and used internally. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific (such as state appropriations), investment income and interest expense are included in nonoperating revenues and expenses.

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

The University prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the University has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, and do not conflict with or contradict GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The University considers all liquid investments with original maturities of three months or less to be cash equivalents. Funds held by the Commonwealth are considered cash equivalents.

Investments and Investment Income

Investments in equity and debt securities are carried at fair value, determined using quoted market prices. Investments in nonnegotiable certificates of deposit, money market accounts and repurchase agreements are carried at cost.

Investment income consists of interest and dividend income and the net change for the year in the fair value of investments carried at fair value.

Accounts Receivable

Accounts receivable consist primarily of tuition and fee charges to students, charges for auxiliary enterprise services provided to students, faculty and staff and receivables from federal, state and private agencies for grants and contracts. Accounts receivable are recorded net of estimated uncollectible amounts.

Loans to Students

The University makes loans to students under various federal and other loan programs. Such loans receivable are recorded net of estimated uncollectible amounts.

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition or fair value at the date of donation in the case of gifts. The University's capitalization policy includes all items with a unit cost of \$1,000 or more and an estimated useful life of greater than one year. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the assets, generally 50 years for buildings, 15 – 20 years for land improvements, 10 years for library books and 5 – 15 years for equipment.

Compensated Absences

University employees begin to accumulate annual vacation allocations from the beginning date of employment, however, accrued vacation is not granted until three months of employment have been completed. The maximum accumulation of vacation leave is limited to the number of days that can be accumulated in two years, based on the length of service. Employees are paid their accumulated vacation upon termination, subject to certain limitations. As of June 30, 2003, the University has recorded an accrued vacation liability of \$2,572,516.

University policies permit most employees to accumulate vacation that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using the regular pay in effect and related benefit costs at the statement of net assets date.

Deferred Revenue

Deferred revenue represents unearned student fees and advances on grants and contract awards for which the University has not met all of the applicable eligibility requirements.

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Net Assets

The University's net assets are classified as follows:

- **Invested in capital assets, net of related debt** – The University's investment in capital assets, net of outstanding debt obligations related to the acquisition, construction or improvement of those assets.
- **Restricted net assets – expendable** – Resources the University is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- **Unrestricted net assets** – Net assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the board.

Release of Restricted Net Assets

When an expense or outlay is incurred for which both restricted and unrestricted net assets are available, the University's policy is to allow each departmental unit the flexibility to determine whether to first apply restricted or unrestricted resources based on the most advantageous application of resources in the particular circumstances.

Scholarship Discounts and Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship allowances in the statement of revenues, expenses and changes in net assets. Scholarship allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants, and other federal, state or nongovernmental programs, are recorded as either operating or nonoperating revenues in the University's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship allowance. The scholarship allowances on tuition and fees and housing for the year ended June 30, 2003, was \$17,653,768. Payments made directly to students are presented as student financial aid expenses in the statement of revenues, expenses and changes in net assets.

Income Taxes

As a state institution of higher education, the income of the University is generally exempt from federal and state income taxes under Section 115(a) of the Internal Revenue Code and a similar provision of state law. However, the University is subject to federal income tax on any unrelated business taxable income.

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Recent Accounting Pronouncements

The Governmental Accounting Standards Board recently issued its Statement No. 39, *Determining Whether Certain Organizations are Component Units, an amendment of GASB Statement No. 14*. The new statement provides additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units in the University's financial statements based on the nature and significance of their relationship with the University. It generally requires reporting, as component units, organizations that raise and hold economic resources for the direct benefit of the University. The University expects to first apply the new statement during the year ending June 30, 2004. The impact of applying the new statement has not yet been determined.

The Governmental Accounting Standards Board recently issued its Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3*. This Statement provides guidance in common deposit and investment risks related to credit risk. The University expects to first apply the new statement for the year ending June 30, 2005. The University does not expect GASB No. 40 to significantly impact its financial statements note disclosures.

Note 2: Deposits, Investments and Investment Return

Cash, Cash Equivalents and Investments

Cash and Cash Equivalents

As of June 30, 2003, the carrying amount of the University's deposits with the state treasurer and other financial institutions was \$37,919,642. This amount consisted of deposits with the state treasurer (\$25,843,144), U. S. financial institutions (\$12,051,637) and petty cash and change funds (\$24,861). Included in deposits with the state treasurer are amounts invested through the state treasurer's cash management program totaling \$2,387,456 at June 30, 2003. For financial reporting purposes, these deposits have been classified as cash equivalents. Deposits held with U. S. financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) for \$100,000 and the University or its agent has pledged securities and repurchase agreements with a market value of \$16,459,805 as collateral for deposits as of June 30, 2003.

The state treasurer requires that all state funds be insured by FDIC, collateralized by securities held by the cognizant Federal Reserve Bank or invested in U. S. Government obligations. The University's deposits with the state treasurer are pooled with funds of other state agencies and then, in accordance with statutory limitations, placed in financial institutions or invested as the state treasurer may determine, in the state's name.

The University requires that balances on deposit with financial institutions be insured by FDIC or collateralized by securities held by the cognizant Federal Reserve Bank, in the University's name.

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Deposits

At June 30, 2003, the University held non-negotiable certificates of deposit totaling \$35,000. These certificates of deposit are fully insured by FDIC. For financial reporting purposes, these deposits have been classified as investments.

Investments

The University's investments are categorized as to custodial credit risk as either (1) insured or registered, with securities held by the University or its agent in the University's name, (2) uninsured and unregistered, with securities held by the counter party's trust department or agent in the University's name or (3) uninsured and unregistered, with securities held by the counter party or by its trust department or agent, but not in the University's name.

At June 30, 2003, the University's investments, all of which are not classifiable by custodial credit risk category as they are not evidenced by specific securities that exist in physical or book entry form, consisted of the following:

	<u>Carrying Value</u>	<u>Fair Value</u>
Money market funds and repurchase agreements	\$ 8,033,844	\$ 8,033,844
S & P Index fund	19,389	19,389
Lehman Bond Index fund	8,477	8,477
Certificates of deposit	<u>35,000</u>	<u>35,000</u>
Total investments	8,096,710	8,096,710
Less restricted investments	(6,000)	(6,000)
Less current investments	<u>(5,459,000)</u>	<u>(5,459,000)</u>
Noncurrent investments	<u>\$ 2,631,710</u>	<u>\$ 2,631,710</u>

Investment Income

Investment income consisted primarily of interest and dividend income and totaled \$1,195,331 for the year ended June 30, 2003.

Eastern Kentucky University
Notes to Financial Statements
June 30, 2003

Note 3: Loans and Accounts Receivable

Loans and accounts receivable are recorded net of estimated uncollectible amounts and consisted of the following at June 30, 2003:

	Gross Receivable	Allowance	Net Receivable
Student tuition and fees	\$ 9,296,660	\$ 5,987,420	\$ 3,309,240
Auxiliary enterprises	304,778	—	304,778
Federal, state and private grants and contracts	8,394,063	—	8,394,063
Other state agencies	406,187	—	406,187
Student loans	6,468,598	363,419	6,105,179
Other	<u>1,361,313</u>	<u>—</u>	<u>1,361,313</u>
Total	26,231,599	6,350,839	19,880,760
Less current portion	<u>20,632,196</u>	<u>6,039,463</u>	<u>14,592,733</u>
Non-current portion	<u>\$ 5,599,403</u>	<u>\$ 311,376</u>	<u>\$ 5,288,027</u>

Note 4: Capital Assets

Capital assets activity for the year ended June 30, 2003, was as follows:

	Balance June 30, 2002	Additions	Reductions	Transfers	Balance June 30, 2003
Capital assets not being depreciated					
Land	\$ 4,995,004	\$ —	\$ —	\$ —	\$ 4,995,004
Livestock for education purposes	378,174	—	8,829	—	369,345
Construction in progress	48,702,064	14,912,650	—	(54,009,121)	9,605,593
Capitalized bond costs	<u>219,014</u>	<u>158,418</u>	<u>—</u>	<u>—</u>	<u>377,432</u>
Total capital assets not being depreciated	<u>54,294,256</u>	<u>15,071,068</u>	<u>8,829</u>	<u>(54,009,121)</u>	<u>15,347,374</u>
Other capital assets					
Land improvements	9,833,119	—	—	133,979	9,967,098
Buildings	152,088,423	—	1,018,170	53,875,142	204,945,395
Equipment	43,104,263	3,979,770	2,312,332	—	44,771,701
Library books	<u>30,683,702</u>	<u>1,203,099</u>	<u>165,565</u>	<u>—</u>	<u>31,721,236</u>
Total other capital assets	<u>235,709,507</u>	<u>5,182,869</u>	<u>3,496,067</u>	<u>54,009,121</u>	<u>291,405,430</u>

Eastern Kentucky University
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June 30, 2003

	Balance June 30, 2002	Additions	Reductions	Transfers	Balance June 30, 2003
Less accumulated depreciation for					
Land improvements	\$ 8,222,247	\$ 200,169	\$ —	\$ —	\$ 8,422,416
Buildings	77,093,296	3,399,299	678,809	—	79,813,786
Equipment	27,782,381	4,499,650	1,374,818	—	30,907,213
Library books	<u>24,688,965</u>	<u>1,103,641</u>	<u>165,565</u>	<u>—</u>	<u>25,627,041</u>
Total accumulated depreciation	<u>137,786,889</u>	<u>9,202,759</u>	<u>2,219,192</u>	<u>—</u>	<u>144,770,456</u>
Total capital assets, net	<u>\$ 152,216,874</u>	<u>\$ 11,051,178</u>	<u>\$ (1,285,704)</u>	<u>\$ 0</u>	<u>\$ 161,982,348</u>

Note 5: Deferred Revenue

Deferred revenue as of June 30, 2003, is as follows:

Unearned summer school revenue	\$ 1,299,823
Unearned grants and contracts revenue	3,015,019
Other – Athletic tickets	70,133
Community workforce and development	28,278
Auxiliary enterprises	44,823
Housing system debt service interest subsidy	<u>11,422</u>
Total	<u>\$ 4,469,498</u>

Note 6: Bonds Payable and Capital Lease Obligations

Long-term liability activity for the year ended June 30, 2003, was as follows:

	Balance June 30, 2002	Additions	Reductions	Balance June 30, 2003	Amounts Due within One Year
Revenue bonds payable	\$ 47,410,000	\$ —	\$ 5,925,000	\$ 41,485,000	\$ 5,430,000
Capital lease obligations	<u>25,890,000</u>	<u>—</u>	<u>910,000</u>	<u>24,980,000</u>	<u>950,000</u>
Total bonds payable and capital lease obligations	<u>\$ 73,300,000</u>	<u>\$ 0</u>	<u>\$ 6,835,000</u>	<u>\$ 66,465,000</u>	<u>\$ 6,380,000</u>

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Consolidated Education Buildings Revenue Bonds

The Consolidated Education Buildings Revenue Bonds, Series A through U, were sold to construct or renovate certain academic and service buildings on campus or to refinance prior issues. The bonds mature in varying amounts through May 1, 2011, with interest payable at rates ranging from 3.9% to 6.2%. Student registration fees are pledged for debt service on these bonds. During the fiscal year, \$4,235,000 of principal and \$1,427,409 of interest were paid on the bonds. On June 30, 2003, the required debt service of \$5,660,144 was on reserve with the trustee. Total principal outstanding at June 30, 2003, was \$28,510,000.

Housing System Revenue Bonds

The Housing System Revenue Bonds, Series A through O, were sold to construct or renovate certain housing facilities on campus or to refinance prior issues. The bonds mature at varying amounts through February 1, 2022, with interest payable at rates ranging from 3.0% to 6.3%. Rental income is pledged for debt service on these bonds. During the fiscal year, \$1,690,000 of principal and \$592,280 of interest were paid on the bonds. On June 30, 2003, the required debt service reserve of \$1,602,698 was on deposit with the trustee. Total principal outstanding at June 30, 2003, was \$12,975,000.

Capital Lease Obligations

In June 2000, the University entered into a financing/lease agreement with the State Property and Buildings Commission to finance the Law Enforcement Basic Training Complex in the amount of \$20,350,000. During the last fiscal year, the University entered into a second financing/lease agreement to finance the Law Enforcement Physical Skills Training Facility in the amount of \$7,075,000. The commission has issued long-term bonds for the project and the University is responsible for the debt service payments on these bonds.

The principal maturities and interest repayment requirements on bonds and capital leases for the next five years and thereafter are as follows:

Year ending June 30	Principal	Interest	Total
2004	\$ 6,380,000	\$ 3,129,681	\$ 9,509,681
2005	6,210,000	2,846,639	9,056,639
2006	6,505,000	2,570,433	9,075,433
2007	6,280,000	2,277,965	8,557,965
2008	4,780,000	1,997,931	6,777,931
2009-13	17,590,000	7,011,764	24,601,764
2014-18	11,680,000	3,759,199	15,439,199
2019-22	<u>7,040,000</u>	<u>680,610</u>	<u>7,720,610</u>
Total	<u>\$ 66,465,000</u>	<u>\$ 24,274,222</u>	<u>\$ 90,739,222</u>

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Assets under capital leases totaled \$27,724,067, net of accumulated depreciation of \$150,000, at June 30, 2003.

Note 7: Related-party Transactions

The University and the Foundation are related parties. The University authorizes the Foundation to solicit contributions on its behalf. In the absence of donor restrictions, the Foundation has discretionary control over the amounts and timing of its distributions to the University.

On August 11, 1981, the Foundation's Board authorized the leasing of Arlington Association, Inc. (Arlington) golf course and facilities (a golf course built and owned by the Foundation on Foundation land) to Arlington for use and benefit of Arlington for a term of one year with automatic renewal for each successive year. As consideration for this lease, various departments of the University are permitted to use the golf course and related facilities for instructional purposes. Arlington bears all expenses for operation and maintenance of the golf course facility and in return, receives all fees related to the operation of the golf course.

The University has a management contract with Arlington whereby the University manages the buildings and grounds and financial affairs of Arlington, provides University personnel for those purposes, and in return, the University receives \$1,200 annually from Arlington. Arlington provides access to University students for various educational classes and golf team activities, and in return, Arlington receives \$44,000 annually. As of June 30, 2003, accounts receivable from Arlington and the Foundation were \$507,746.

Note 8: Pension Plans

All full time University faculty members and certain other staff occupying a position requiring certification or graduation from a four-year college or university, as a condition of employment, are covered by the Kentucky Teacher's Retirement System (KTRS), a defined benefit plan. KTRS, a cost sharing, multiple-employer, public employee retirement system, provides retirement benefits based on an employee's final average salary and number of years of service. Benefits are subject to certain reductions if the employee retires before reaching age 60 or has less than 27 years of participation in the plan. The plan also provides for disability, death and survivor benefits and medical insurance. Under the plan, members contribute 6.16% of their annual salary and the University contributes 13.84%.

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June 30, 2003

Effective August 1, 1996, there are three optional 403(b) defined contribution retirement plans available for new employees who would otherwise be covered by the KTRS. The providers of the optional retirement plans are Aetna (ING), TIAA/CRFF and Valic. The employee contribution to their selected plan is 6.16% of their annual salary. As determined by the KTRS Board of Trustees the University contributes 9.26% and also provides an additional 4.58% to KTRS as an unfunded liability in fiscal year 2002-03. The total of the University contribution does not exceed 13% but the allocation between contribution to the plan and the unfunded liability is subject to change each year. The University contribution for fiscal year 2003-04 will be 8.21% with an additional 5.63% as an unfunded liability.

The KTRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Teachers Retirement System, 479 Versailles Road, Frankfort, KY 40601-3800 or by calling 502 573-3266.

Substantially all other full-time University employees are required by law to participate in the Kentucky Employee Retirement System (KERS), a cost sharing multiple-employer, public employee retirement system. KERS provides retirement benefits based on an employee's final average salary and number of years of service. Benefits are subject to certain reductions if the employee retires before reaching age 65 or has less than 27 years of service. The plan also provides for disability, death and survivor benefits and medical insurance. Employees in nonhazardous positions contribute 5% of salary. Employers contribute at the rate determined by the KERS Board of Trustees to be necessary for the actuarial soundness of the systems as required by KRS 61.565. The employer rate is reviewed annually following valuation of the plan. The current University contribution rate to KERS is 5.89%.

The KERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Employees Retirement System, 1260 Louisville Road, Perimeter Park West, Frankfort, KY 40601 or by calling 502 564-4646.

Currently there are no University employees occupying positions that would be considered as hazardous under KERS regulations.

The total pension cost for all retirement plans for the year ended June 30, 2003, was \$9,005,310. Pension costs for the years ended June 30, 2002 and 2001, were \$9,470,288 and \$9,092,266, respectively.

Eastern Kentucky University

Notes to Financial Statements

June 30, 2003

Note 9: Commitments and Contingencies

Self-insured Health Plan

The University has a self-insured health insurance plan. Under this plan, the University pays premiums based on estimated claims. For the year ended June 30, 2003, the University discontinued catastrophe insurance coverage it obtained in prior years. The University made a non-discretionary allocation to the health care self-insurance reserve in the amount of the former catastrophe insurance coverage fee.

The University maintains a self-insurance program for employees' health insurance. The University pays approximately 88% of the expenses of the plan for permanent full-time employees and their families. Expenses incurred to cover claims paid by the University under the plan for years ended June 30, 2003 and 2002, totaled \$7,437,943 and \$6,750,428, respectively, excluding administrative and stop-loss fees. Administrative fees incurred for the years ended June 30, 2003 and 2002, were \$665,237 and \$616,925, respectively. For the year ended June 30, 2002, the University incurred stop-loss fees totaling \$495,143. The University's stop-loss insurance for the year ended June 30, 2002, limited its exposure for claims to \$100,000 per individual.

Changes in the liability for self insurance are follows:

	2003	2002
Liability, beginning of year	\$ —	\$ 355,021
Accruals for current year claims and changes in estimate	8,428,292	7,507,475
Other costs	(665,237)	(1,112,068)
Claims paid	<u>(7,437,943)</u>	<u>(6,750,428)</u>
Liability, end of year	\$ <u>325,112</u>	\$ <u>—</u>

Construction Commitments

The estimated cost to complete construction projects under contract at June 30, 2003, is approximately \$26,680,876. The projects are to be financed principally by appropriations from the Commonwealth and proceeds from bonds.

Claims and Litigation

The University is a party to various litigation and other claims in the ordinary course of business. University officials are of the opinion, based upon the advice of legal counsel, that the ultimate resolution of these matters will not have a material effect on the financial position of the University.

Eastern Kentucky University
Notes to Financial Statements
June 30, 2003

Government Grants

The University is currently participating in numerous grants from various departments and agencies of the federal and state governments. The expenditures of grant proceeds must be for allowable and eligible purposes. Single audits and audits by the granting department or agency may result in requests for reimbursement of unused grant proceeds or disallowed expenditures. Upon notification of final approval by the granting department or agency, the grants are considered closed.

Note 10: Risk Management

The University is exposed to various risks of loss from torts, theft of, damage to, destruction of assets, business interruption, employee injuries and illnesses, natural disasters and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from these risks, other than employee health. Settled claims have not exceeded this commercial coverage in any of the three preceding years. As a sovereign entity of the Commonwealth, the Kentucky Board of Claims handles tort claims on behalf of the University.

The Commonwealth operates a public entity risk pool operating as a common risk management and insurance program for its members. The University pays an annual premium to the pool for its workers' compensation insurance coverage. The pool's governing agreement specifies that the pool will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of specified stop loss amounts.

Note 11: Operating Expenses by Natural Classification

For the year ended June 30, 2003, the University's operating expenses by natural classification were as follows:

Salaries and wages	\$ 99,201,630
Employee benefits	24,819,667
Supplies and other services	22,578,977
Travel	3,147,958
Depreciation	9,202,759
Student scholarships and financial aid	8,882,666
Utilities	5,091,628
Other operating expenses	<u>2,954,577</u>
Total	<u>\$ 175,879,862</u>

Eastern Kentucky University
Notes to Financial Statements
June 30, 2003

Note 12: Adjustments Applicable to Prior Year

During 2003, the University determined through its implementation of new accounting software systems that capital assets, net of accumulated depreciation, were overstated by \$13,840,528 at June 30, 2002, due to computational errors and misapplication of ownership information. Additionally, the University determined that accrued interest payable on long-term debt obligations was understated by \$755,331, as this liability was not recorded at that date due to an oversight. Finally, during 2003, the University ascertained that deferred revenue at June 30, 2002, was understated by \$27,980 due to a computational error. The beginning balance of net assets at July 1, 2002, has been adjusted by \$27,980 due to a computational error. The beginning balance of net assets at July 1, 2002, has been adjusted for these matters as follows:

Overstatement of capital assets, net of accumulated depreciation	\$ (13,840,528)
Understatement of accrued interest payable	(755,331)
Understatement of deferred revenue	<u>(27,980)</u>
	\$ <u>(14,623,839)</u>

Also, during 2003, the University changed its method of accounting for Federal capital contributions to the Perkins Loan Program as revenue from government-mandated nonexchange transactions instead of as a long-term liability. The University believes that the new method better reflects the nature of the transactions as the University would be responsible for the return, if any, of all or a portion of the capital contributions to the Federal government only if the University ceases participation in the program and the Federal government exercises its prerogative to seek reversion of the monies. The cumulative effect of this change in accounting principle has been reflected as an increase of \$5,993,333 in the beginning balance of net assets at July 1, 2002.